

## Message Text

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ACTION EA-12

INFO OCT-01 EUR-12 ISO-00 SP-02 ICA-11 AID-05 EB-08  
NSC-05 TRSE-00 SS-15 STR-07 OMB-01 CEA-01 L-03  
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R 310605Z JUL 78  
FM USLO PEKING  
TO SECSTATE WASHCC 1517  
INFO AMCONSUL HONG KONG  
AMEMBASSY PARIS  
AMEMBASSY SINGAPORE  
AMEMBASSY TAIPEI  
AMEMBASSY TOKYO  
CINCPAC

C O N F I D E N T I A L SECTION 1 OF 3 PEKING 2325

CINCPAC FOR POLAD

E.O. 11652: GDS  
TAGS: ECON CH

SUBJ: PRC INDUSTRIAL PERFORMANCE AT MIDYEAR: COMMENTS

1. SUMMARY: AT MIDYEAR 1978 CHINA APPEARS TO BE IN A  
RELATIVELY FAVORABLE ECONOMIC POSITION. THIS IS PARTICULARLY  
TRUE IN POLICY AREAS WHERE THE POST-MAO LEADERSHIP  
IS CHARTING A PRAGMATIC ECONOMIC COURSE. THE GREATEST  
THREAT TO STEADY ECONOMIC GROWTH NOW MAY BE NATURAL  
DISASTERS THAT COULD MAKE IT IMPOSSIBLE FOR  
AGRICULTURE TO UNDERWRITE RAPID INDUSTRIALIZATION. ACTUAL  
ECONOMIC PERFORMANCE DURING THE FIRST HALF HAS BEEN MOSTLY  
GOOD. OFFICIAL GVIO CLAIMS INDICATE THAT THE ECONOMY IS  
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ON A GROWTH TRACK AND THAT INDUSTRY IN GENERAL IS  
PERFORMING FAIRLY WELL. HOWEVER, SOME TRENDS IN THE  
ENERGY SECTOR ARE WORRISOME. COAL AND ELECTRIC POWER  
HAVE PUT IN CREDITABLE PERFORMANCES, BUT GROWTH RATES  
ARE LIKELY TO DECLINE SUBSTANTIALLY IN THE SECOND HALF.  
PETROLEUM PRODUCTION GROWTH RATES HAVE LEVELED OFF AND  
MAY INDICATE SEVERE DIFFICULTIES IN RAISING PRODUCTION

FROM MAJOR FIELDS. THE STEEL INDUSTRY IS MAKING A VERY SLOW RECOVERY FROM THE DEPTHS IT HIT IN 1976. RAILWAY TRANSPORT'S PERFORMANCE IS PROBABLY IMPROVED BUT WE LACK GOOD INDICATORS FOR THIS SECTOR. CHEMICAL FERTILIZER PRODUCTION IS SUBSTANTIALLY UP, PARTLY DUE TO COMMISSIONING OF MORE FOREIGN PLANTS. LIGHT INDUSTRY AND TEXTILES SEEM TO BE PERFORMING ONLY FAIRLY WELL. WE BELIEVE THAT REACHING THE TEN-YEAR PLAN TARGET OF OVER TEN PERCENT INDUSTRIAL GROWTH WILL NOT BE DIFFICULT THIS YEAR. END SUMMARY.

2. OVERVIEW. AT MIDYEAR 1978 THE PRC INDUSTRIAL SECTOR IS ENJOYING THE MOST FAVORABLE CONDITIONS IT HAS KNOWN FOR SEVERAL YEARS. THIS IS PARTICULARLY TRUE WITH RESPECT TO THE POLICY ENVIRONMENT. THE LEADERSHIP HAS ISSUED A NEW SET OF INDUSTRIAL REGULATIONS -- THE THIRTY POINTS -- THAT SHOULD SIGNIFICANTLY INCREASE PRODUCTION AND EFFICIENCY IN THE LONG RUN. THE HIGHER LEVELS OF ECONOMIC MANAGEMENT HAVE BEEN RE-STAFFED WITH EXPERIENCED CADRES AND AN ULTIMATELY BENEFICIAL (THOUGH NOW POTENTIALLY DISRUPTIVE) RECTIFICATION CONTINUES AT LOCAL LEVELS. THE CENTRAL GOVERNMENT HAS APPARENTLY RESOLVED THE QUESTION OF THE DEGREE OF ADMINISTRATIVE CENTRALIZATION WITH A REASONABLE COMPROMISE; NAMELY; RETAINING LOCAL ADMINISTRATION WHILE INCREASING CENTRAL CONTROLS VIA THE FINANCE AND TRADE NETWORK, AND, AT THE SAME TIME, REORGANIZING CERTAIN INDUSTRIES UNDER THE

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DIRECT ADMINISTRATIVE SUPERVISION OF CENTRAL CORPORATIONS. THERE HAS ALSO BEEN SOME IMPROVEMENT IN THE FOREIGN TRADE SECTOR. DECISIONS HAVE APPARENTLY BEEN MADE REGARDING THE ROLE OF FOREIGN TECHNOLOGY IN SOME KEY AREAS, FOR EXAMPLE, METALS AND MINERALS EXTRACTION AND PROCESSING. PLANS FOR WHOLE PLANT PURCHASES MAY BE NEARLY COMPLETE, THOUGH AS YET FEW NEW CONTRACTS HAVE BEEN SIGNED.

3. THESE POSITIVE DEVELOPMENTS TAKE PLACE AGAINST THE BACKGROUND OF AN ECONOMY THAT IS STILL BACKWARD AND HARRASSED BY STRUCTURAL BOTTLENECKS AND OTHER WEAKNESSES FURTHERMORE, AS CADRE FEARS OF COMMITTING "RIGHTIST" ERRORS ARE NATURALLY GREAT AFTER TWELVE YEARS OF POLITICAL TURMOIL, IMPLEMENTATION OF THE NEW PRAGMATIC POLICIES IS LIKELY TO BE SLOW. THIS IS THE FIRST YEAR DURING WHICH THE LEADERSHIP IS EXPECTING THE ECONOMY TO MEASURE UP TO THE GROWTH CRITERIA SET FORTH IN THE TEN-YEAR PLAN. ALTHOUGH WE DEAL ONLY WITH INDUSTRY HERE, WE WOULD SUGGEST THAT THE GREATEST THREAT TO STEADY ECONOMIC GROWTH NOW MAY BE SHORTFALLS IN AGRICULTURAL PRODUCTION THAT WILL REQUIRE ENLARGED FOOD

IMPORTS AND MAKE IT IMPOSSIBLE FOR AGRICULTURE TO  
UNDERWRITE INDUSTRIALIZATION.

4. GROSS VALUE OF INDUSTRIAL OUTPUT: OUR CALCULATIONS  
SUGGEST THAT THE VALUE OF GOODS PRODUCED IN THE FIRST  
HALF OF THIS YEAR WAS ABOVE THAT OF THE SECOND HALF OF LAST  
YEAR AND A NEW HALF YEAR RECORD. NCNA ON JULY 6 CLAIMED A  
24.6 PERCENT INCREASE IN THE FIRST HALF GVIO OVER THE  
FIRST HALF OF 1977. THE CLAIMED RATE IS LARGELY PARTLY  
BECAUSE THE FIRST QUARTER OF 1977 WAS EXTREMELY DEPRESSED.  
THESE FIGURES SUGGEST THAT THE ECONOMY IS BACK AT LAST  
ON A GROWTH TRACK AFTER A WEAK FOURTH QUARTER 1977 AND  
FIRST QUARTER 1978. WE EXPECT GROWTH TO CONTINUE IN THE  
THIRD AND FOURTH QUARTERS. PARTLY BECAUSE OF THE  
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DEPRESSION IN THE FIRST QUARTER OF LAST YEAR, A SUBSTANTIAL  
--OVER 15 PERCENT -- GROWTH CLAIM IS PROBABLE  
BY YEAR END.

5. ENERGY: PETROLEUM PRODUCTION MAY BE DEVELOPING INTO  
MEDIUM-TERM BOTTLENECK. NCNA OF JULY 3 CLAIMED A FIRST

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R 310605Z JUL 78  
FM ULSO PEKING  
TU RUEHC/SECSTATE WASHDC 1518  
INFO AMCONSUL HONG KONG  
AMEMBASSY PARIS  
AMEMBASSY SINGAPORE  
AMEMBASSY TAIPEI  
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C O N F I D E N T I A L SECTION 2 OF 3 PEKING 2325

CINCPAC FOR POLAD

HALF CRUDE OIL PRODUCTION INCREASE OF 11.2 PERCENT OVER THE FIRST HALF OF LAST YEAR. THIS COMPARES WITH A FIRST QUARTER INCREASE CLAIM OF 10.3 PERCENT OVER THE FIRST QUARTER OF 1977. SINCE PRODUCTION GROWTH RATES DECLINED DURING 1977, THE 1978 HALF YEAR CLAIM MAY INDICATE A LEVELING OFF OR EVEN DECLINE IN CURRENT GROWTH RATES. THIS IS WORRISOME AT A TIME WHEN THE ECONOMY AS A WHOLE SEEMS TO BE ON A GROWTH TRACK AND MAY REFLECT DIFFICULTIES IN OBTAINING HIGHER EXTRACTION RATES AT EXISTING FIELDS. THE CHINESE ARE NOW PROMOTING STRICTER CONSERVATION. THEY ARE ALSO DRILLING NEW WELLS AT A FRENETIC PACE. NCNA ON JULY 3 REPORTED THAT DRILLING FOOTAGE FROM JANUARY - JUNE WAS UP 66.7 PERCENT OVER THE COMPRAABLE 1977 PERIOD. (WE ADD HERE A DISSENTING REPORT. AN AMERICAN GEOLOGIST WHO VISITED  
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TACHING THE SECOND WEEK IN JULY TOLD USLO THAT PRODUCING WELLS, INCLUDING SOME OF THE MOST PRODUCTIVE WELLS, ARE BEING CAPPED. PRODUCTION IS, ACCORDING TO THIS SOURCE, BEING HELD DOWN DELIBERATELY BECAUSE IT IS NOT NOW NEEDED.) HE ADDS THAT THE FIELD IS BEING EXPANDED IN AREA.)

6. ANOTHER MEDIUM-LONG TERM PROBLEM MAY BE A SHORTAGE OF REFINING CAPACITY. CRUDE OIL PROCESSING WAS REPORTED UP 8.1 PERCENT OVER LAST YEAR, WHICH IS PROABLY BELOW LONG-RANGE GROWTH REQUIREMENTS.

7. NCNA ON JULY 6 CLAIMED A 19.3 PERCENT FIRST HALF INCREASE IN CRUDE COAL OOTPUT OVER THE FIRST HALF OF 1977. IT WAS STATED THAT PRODUCTION HAD ALREADY FULFILLED 55 PERCENT OF THE ANNUAL PLAN. THE 19.3 PERCENT FIGURE IS IMPRESSIVE WHEN WE CONSIDER THAT THE FIRST HALF OF 1977 WAS NOT A BAD ONE FOR COAL (WE HAVE BEEN TOLD THAT TOTAL PRODUCTION IN 1977 WAS 500 MILLION TONS). THE GREATEST PART OF THIS INCREASE IS PROBABLY ATTRIBUTABLE TO SUCCESSES IN RAISING WORKER PRODUCTIVITY AND TO TAPPING EXISTING EQUIPMENT AND CAPACITY POTENTIAL AT OLD MINES. THESE SUCCESSES ARE LARGELY A "ONE TIME" SHOT IN THE ARM, AND OUTPUT GROWTH FROM BETTER PRODUCTIVITY WILL LIKELY BE SLOWER IN THE SECOND HALF. ALTHOUGH THIS SECTOR HAS PERFORMED WELL UP TO NOW, THERE IS A NEED FOR NEW ADDITIONS TO CAPACITY TO ASSURE CONTINUED GROWTH. SUCH ADDITIONS ARE PLANNED (PEKING 2144), BUT SHORT-TERM PROSPECTS

ARE STILL FOR TIGHT SUPPLIES.

8. THE ELECTRIC POWER SECTOR CONTINUES TO PUT IN THE STRONG PERFORMANCE THAT LOOKED PHENOMENAL IN THE FIRST QUARTER WHEN COMPARED TO A DEPRESSED PERIOD IN 1977. NCNA CLAIMED AN INCREASE OF 17.7 PERCENT FOR THE HALF OVER THE FIRST  
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HALF OF 1977. THE FIRST QUARTER CLAIM WAS A 22.9 PERCENT INCREASE OVER THE FIRST QUARTER OF 1977. THIS RATE OF GROWTH IS LIKELY TO ALL BY YEAR-END. MEDIA REPORTS CONTINUE TO SAY THAT ELECTRICITY SUPPLY REMAINS LESS THAN DEMAND. WHAT PRESENT TRENDS APPEAR TO PROMISE IS THAT THE ELECTRICITY BOTTLENECK WILL NOT GROW SUBSTANTIALLY WORSE THIS YEAR.

9. STEEL: A FIRST HALF INCREASE OF 66.9 PERCENT IN STEEL PRODUCTION COMPARED WITH THE BAD PERFORMANCE OF THE FIRST HALF OF 1977 WAS CLAIMED BY NCNA ON JULY 6. DESPITE THIS, A MAY 19 PEOPLE'S DAILY EDITORIAL (HONG KONG 6757) AND OUR OWN CALCULATIONS SUGGEST THAT THIS INDUSTRY IS STILL PRODUCING ONLY AT OR SLIGHTLY ABOVE THE LEVELS OF THE SECOND HALF OF 1977. PRODUCTION IS FAR BELOW REQUIREMENTS AND IMPORTS ARE AT RECORD LEVELS, APPROXIMATELY 6.5 MILLION TONS. THE CHINESE ARE ADMITTING THAT RECOVERY TO THE 1975 LEVEL OF PRODUCTION WILL PROBABLY NOT BE REALIZED UNTIL NEXT YEAR. REPORTS OF PERFORMANCES OF INDIVIDUAL MILLS HAVE BEEN VERY SKETCHY AND THE MEDIA HAVE BEEN LARGELY SILENT ON PAOTOU AND MAANSHAN, AMONG THE LARGER MILLS. IT NOW APPEARS THAT THE NEW 1.5 MILLION TON STEEL MILL IN WUHAN WILL NOT BE MAKING A LARGE CONTRIBUTION TO PRODUCTION THIS YEAR. IF IT MEETS ITS 6.5 MILLION TON PLAN THIS YEAR, ANSHAN WILL STILL BE PRODUCING ONLY AT ITS PREVIOUS PEAK LEVEL.

10. CHEMICAL FERTILIZER WAS REPORTED BY PEKING REVIEW TO BE UP 47 PERCENT OVER THE FIRSTHALF OF 1977. AN NCNA REPORT FOR THE PERIOD THROUGH JUNE 15 CLAIMED THAT NITROGENOUS FERTILIZER WAS UP 59.1 PERCENT AND PHOSPHATE FERTILIZER WAS UP 33.2 PERCENT OVER THE SAME 1977 PERIOD. NITROGENOUS FERTILIZER CONSTITUTES THE BULK OF CHEMICAL FERTILIZER PRODUCED SO THE LARGE INCREASE IN THIS OUTPUT  
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--ATTRIBUTABLE TO A LARGE EXTENT TO THE COMMISSIONING OF IMPORTED PLANTS -- LARGELY ACCOUNTS FOR THE HIGH OVERALL GROWTH FIGURES. ACCORDING TO NCNA, OUTPUT WAS UP 8.5 PERCENT IN THE FIRST QUARTER OVER THE FOURTH QUARTER OF LAST YEAR, AND AVERAGE DAILY OUTPUT IN EARLY AND MID-JUNE WAS UP 19 PERCENT OVER JANUARY. ONE NEW FOREIGN PLANT, THE KELLOGG PLANT IN SHUIFU, YUNNAN, WAS COMMISSIONED IN THE FIRST QUARTER. VERY LIKELY OTHER IMPORTED, AS WELL AS CHINESE PLANTS, BEGAN TO PERFORM BETTER DURING THIS PERIOD. THE OUTLOOK IS FOR LARGE INCREASES IN PRODUCTION IN THE SECOND HALF. THE FRENCH EMBASSY NOW SAYS THAT THE HUERTY PLANT IN NANKING, WHICH WAS SCHEDULED FOR TEST-RUNS IN JUNE, WILL ENTER PRODUCTION IN AUGUST. THE HUERTY PLANTS IN BOTH KWANGCHOW AND ANCHING, ANHWEI, ARE NOW EXPECTED TO BEGIN PRODUCTION BEFORE YEAR END. THE SIXTH KELLOGG PLANT, IN CHIHSHUI, KWEICHOW, MAY ALSO ENTER PRODUCTION IN THE SECOND HALF.

11. LIGHT INDUSTRY APPEARS TO BE PERFORMING MODERATELY WELL. TOTAL OUTPUT VALUE WAS REPORTED BY NCNA TO BE UP

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R 310605Z JUL 78  
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CINCPAC FOR POLAD

BY MORE THAN 20 PERCENT OVER THE FIRST HALF 1977. THE FIRST QUARTER OF LAST YEAR WAS A BAD ONE FOR THIS INDUSTRY, SO THE HALF YEAR FIGURE SUGGESTS NORMAL RATHER THAN EXCEPTIONAL GROWTH. THE IMPORTANT TEXTILE INDUSTRY APPEARS TO BE PUTTING IN A SIMILAR PERFORMANCE, WITH OUTPUT UP 26 PERCENT OVER THE FIRST HALF OF LAST YEAR, CONSIDERING AGAIN THAT THE FIRST QUARTER OF 1977 WAS POOR.

12. TRANSPORT: AFTER CLAIMING A 30.2 PERCENT INCREASE IN RAIL-FREIGHT VOLUME IN THE FIRST QUARTER OVER THE FIRST QUARTER OF 1977, NCNA HAS CLAIMED A 22.4 PERCENT INCREASE FOR THE FIRST HALF COMPARED WITH LAST YEAR. HUA KUO-FENG TOLD THE FINANCE AND TRADE CONFERENCE THAT "COMMUNICATIONS AND TRANSPORT DID VERY WELL." WE ARE CONFIDENTIAL

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INCLINED TO AGREE BUT HAVE SOME RESERVATIONS. WE LACK FIGURES, BUT WE CONSIDER AN IMPROVEMENT LIKELY ALTHOUGH THE RAILWAYS UNDOUBTEDLY STILL CONSTITUTE A BOTTLENECK. WE HAVE HEARD FEWER COMPLAINTS ABOUT RAILWAY CONGESTION RECENTLY. ON THE OTHER HAND, WE ARE PUZZLED BY THE FAILURE TO PUBLICIZE CLAIMS FOR INDIVIDUAL BUREAUS.

13. FINANCE: NCNA CLAIMED AN INCREASE OF 65.3 PERCENT IN PROFITS REMITTED TO THE STATE COMPARED WITH THE FIRST HALF OF LAST YEAR. THIS IS AN IMPRESSIVE FIGURE WHICH SUGGESTS IMPROVEMENTS IN LABOR PRODUCTIVITY, BETTER ACCOUNTING, MATERIALS MANAGEMENT, AND PERHAPS MOST IMPORTANTLY FOR THE PERIOD TO WHICH PRESENT PERFORMANCE IS BEING COMPARED, IMPROVED UTILIZATION OF CAPACITY.

14. IN SUM, WE BELIEVE THAT FIRST HALF INDUSTRIAL PERFORMANCE HAS BEEN GENERALLY GOOD AND THAT THE ECONOMY HAS GROWN SLOWLY. WE FIND INDUSTRY IN GENERAL DOING REASONABLY WELL ALTHOUGH IN SOME SECTORS INCREASES REPRESENT RECOVERY. STEEL REMAINS A WEAK LINK AND RAILWAY TRANSPORT MAY BE CONSTRAINING GROWTH. TRENDS IN CRUDE OIL PRODUCTION AND REFINING CAPACITY ARE CAUSES FOR CONCERN, AS IS THE PROSPECT THAT COAL AND ELECTRIC POWER GROWTH RATES WILL DECLINE BY YEAR END. ON THE OTHER HAND, PROFIT REMITTANCES ARE UP AND INDUSTRY IN GENERAL SEEMS TO BE ON A GROWTH TRACK. PERHAPS MOST IMPORTANT, PRAGMATIC POLICIES HAVE BEEN ANNOUNCED AND ARE BEING SLOWLY IMPLEMENTED. THESE POLICIES SHOULD IN THE FUTURE HELP THE COUNTRY ACHIEVE EVEN FASTER GROWTH. AT PRESENT, WE BELIEVE THAT THE TEN-YEAR PLAN TARGET OF 10 PERCENT PER ANNUM GROWTH WILL NOT BE DIFFICULT TO ACHIEVE THIS YEAR, AND GROWTH OF INDUSTRY MAY WELL

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EXCEED 15 PERCENT. THE PLAN TARGET IS LIKELY TO BE MUCH  
MORE DIFFICULT TO MEET NEXT YEAR.  
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## Message Attributes

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